CO-OP CREDIT UNION

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February 7, 2014

The Honorable Debbie Matz, Chairman
The Honorable Micheal Fryzel, Board Member
The Honorable Richard Metzger, Board Member
1775 Duke Street
Alexandria, VA 22314

RE: Risk Based Capital Rule

Dear Chairman Matz, Board Member Fryzel and Board Member Metzger,

I am writing with my concerns on the proposed risk-based capital rule. I am very concerned about the discrimination present in this proposed regulation towards credit unions who have the "carve out" in the law because they were started for the purpose of making member business loans; an exemption put in the law by legislators for credit unions like ours. There at the very least has to be a carve out in this risk-based capital regulation for our type of credit union whose culture has been business lending and who have a history with member business loans and this type of lending. I apologize in advance for the length of the letter, but the regulation is 198 pages long, it took me a while to read the regulation. It is a major change for credit unions and their ability to do business.

This regulation is trying to seriously limit lending in our type of credit union. Credit unions that have the member business loan waiver are not doing something new, it is what they have been doing since they started doing business. Our credit union has had more losses in car loans than we have had in farm and business loans during the 74 years we have been here to serve our membership and our losses have never been excessive. During that time there have been ups and downs in the economy in our area. The more we try and help those that are in our field of membership, the more this proposed regulation would penalize us as we need to have more and more capital to do so with the tier based system. We cannot diversify our loan portfolio by hoping to lend money to our members for purposes for which they have no need. We only have one county in our field of membership that has more than 10,000 people living in it. Most of the counties are significantly less populated than that. That gives you an idea of how rural our area is. We have county seats in some of our counties with less than 1500 people in the town.

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Here are a few examples of issues I have with this regulation being a manager of a credit union that was started for the purpose of making business loans:

The regulation does not take into consideration the fact that there is a difference between a credit union that finances farm land and lends a maximum dollar amount per acre or the credit union that will lend at 80% of value. In today's environment with high land values that are in excess of $10,000 per acre in our area it would be a loan value of $8000.00 per acre if we loaned 80%. Our credit union finances a maximum of $3000.00 per acre giving us room if values of farm land goes down. This makes our ag real estate some of the safest loans we have. We also have only short-term loans so interest rate risk is minimal. Reasons for this are not just that we think that would be a good number, we looked at history. In the 1980's the ag sector was as bad as 2008 was for the residential real estate sector; farm land dropped 60% in the 1980s. We want the amount that we finance to be safe in a bad farm environment, if land would drop to $4000.00 per acre or 60% we would still have adequate collateral.

I would have to ask how many of the failed credit unions in the past actually failed because of business and ag loans? Were the credit unions that failed started for the purpose of business lending or did they step outside of their expertise and step in too deep in something they had no history with? I think we may find out the significant losses were not with the credit unions that have been in business lending since they started. The legislators made sure that credit unions, especially those in rural areas could continue to serve their members. NCUA needs to be respectful of that decision and not try to get around it by creating new excessive requirements with proposed risk-based capital regulation.

This proposed regulation does not allow for economic downturns. For example, if we did fall down under the well capitalized section because of economic downturn; even though we would have above 8% capital after recognizing all of the losses and there was very little risk left in the remaining portfolio there would be no realistic way to work our credit union out of the situation because we would have to "walk" the healthy loans that this regulation considers higher risk just to meet the increased capital requirements our type of lending singles out in this proposed regulation. Rebuilding with this regulation is almost impossible.

The above scenario is no different for residential real estate. Our loan officers sat around the board table at loan meetings wondering when the real estate bubble would burst in this country. It did. We knew we would not be adversely affected when it did. Our credit union did not suffer losses. We did not promote open end home equity loans to our membership. We did not finance 100% of value. If we kept a real estate loan on our books, the members needed to have 20% down. Our average loan size for first mortgages is $55,000.00. Median loan size is $35,000. Interest rate risk is minimal because we use 5 year balloon products; which we will be able to continue to offer with the new ability to pay laws because we qualify as rural. However, the way this new regulation is written all of our first mortgage loans will have to fall into the higher reserve requirements of other real estate because we did not complete formal documentation to verify income that is required for the loans to be considered as first mortgages in this proposed regulation . It was not required by regulation at the time we did the loans to have written verification. In small communities we know if someone is working or not, and we know where they work. We also know if the amount of income that they put on their application is reasonable for the employer and the job they have with the employer. We can look at their checking account deposits if we question it. Formal verification of income is only good on the day it is done. I am sure many of the secondary market real estate loans that were done where significant losses were incurred had formal income verifications on file. It makes no difference if the financial institution has the verifications on file if the borrower loses their job. I would be willing to bet most of the employers said "Good" in the blank spot on the verification form where the employer has to fill out the likelihood of continued employment. Why should we have to "pay" for the zero documentation loans that were done by entities that had absolutely no idea who the person was that they were dealing with? If someone came in our door and we did not know who they were or where they worked, we would have verified his or her income. Being punished after the fact on seasoned loans that are no more risk to the fund than the loans with documentation of verification of income is unfair to the credit unions that take pride in knowing their members and are interested in the well being of those members.

Another concern that I have is only allowing a maximum of 1.25% of risk assets for ALLL balance. Credit unions like ours that have portfolios of ag and business loans where they are allowed by GAAP to reserve for each loan individually in the ALLL rather than just use historical data, are definitely adversely affected with this regulation. If we used only historical data our ALLL would be significantly less. We set aside for individual loans in our business and ag loan that have weaknesses; we set aside for the portfolios in general; and we set aside for economic downturns such as commodity prices, farm bills etc, which we monitor constantly. This addition to our ALLL covers concentration risk; however we will not get to include that amount in the calculations in the risk based capital proposal. Credit unions will have a lot less incentive to include economic downturns as a part of their calculations, which protects the credit union and mitigates the concentration risk in the member business loan portfolio. Also, with the changes that FASB has been hashing around that could double ALLL balance requirements there would be an even larger amount of money in the ALLL reserve that would not be eligible in calculating Risk-Based Net worth.

In our portfolio, loans are very cyclical (agricultural loans that match the growing cycle). We could be in one category one quarter; fall to the next category the following quarter and back to the previous category in the third quarter. With the constant flux that NCUA keeps credit unions in, we cannot do any long term planning. Planning is very hard to do if we don't know from one minute to the next where arbitrary changes to regulations are going to put us. On the other hand it is about the only kind of lending in our area, so diversifying is easier said than done.

The new regulation requires loans on non accrual to be included in with the delinquency numbers on the risk-based calculations. We have loans that are non accrual because they are weak but they are paying and performing and they are ag and business loans so they are reserved for in the ALLL by individual loan. Here are a couple of scenarios. We have a balance on a business loan that a parent is paying. The child's business is no longer operating. The parent pays us once a year and has for multiple years. We have reserved individually for that loan at 100% in the ALLL calculation because of our collateral position. We will not be able to count all of our ALLL and we will have to place it in the higher reserve requirement in the delinquency category. Another loan was identified as weak several years ago because of our collateral position; at that time had a balance of $800,000. We reserved 100% and continue to do business with this person. The loan is down to $122,000 and we are still reserving individually for this loan in the ALLL at a 100% of the outstanding balance . This would be another situation where we are individually reserving and will have to include it as delinquent and have higher reserve requirements. Our credit union's caught in the double jeopardy trap. This regulation does not take into consideration the balances in ALLL if the credit union is able, under GAAP, to reserve for individual loans.

It appears this regulation takes away the power of giving permission to declare dividends from the states if the credit union is state chartered. NCUA should not continue to write their regulations taking away the state powers which takes away more and more local power and puts more and more power in Washington.

I have been managing this credit union for 30 plus years and am very aware that 7% or even 8% capital would not be where we want to be with the types of loans that we do. This regulation does not allow for hard economic times (which we all know are a part of life) that would cause a credit union to have to rebuild capital. This regulation puts NCUA in total control of management of every credit union with the ability for them to increase the amount of capital required for literally any reason. I believe at this point in time, the way the regulation is written, there is not one credit union that would be exempt from the risk of higher capital requirements with NCUA's all inclusive listing of reasons to require more capital. NCUA can require increases to capital for something as simple as they don't like the credit unions policies; along with a whole list of other reasons with no parameters of when NCUA can use these expanded powers. This gives NCUA unlimited powers to tell a boards of directors how to manage their credit unions. I do not believe that it is the role of NCUA to micromanage credit unions.

At this point, without each credit union building a "what if" program on their own, that does not automatically prefill from the call report information like the one on the NCUA website, there is no way of moving numbers from one section to another to figure out where the credit union be will be if this regulation becomes effective. This could cause credit unions to be complacent about this proposed regulation as all of the changes to the call report will increase the credit unions reserve requirements. I believe credit unions that engage in ag and business lending will move one category lower that the calculator shows they are today.

There are also problems with the investment calculations but in the interest of not making this letter any longer I will let other credit unions address the investment issues. At first glance it appears in a time of high interest rates when a credit union should probably make investments for a little longer than three months, they will be penalized. The vast majority of our investments are in federally insured CDs. Again, I have not studied this section of the regulation in depth.

A lot more thought needs to go into this regulation. I urge NCUA to call me if they have concerns about my letter and listen to the input that they receive from other credit unions and trade associations. The last thing that I want to have happen is excessive losses to the fund; but regulating to assure no loss could backfire.

Thank you for your time spent reading my letter.

Sincerely
Co-op Credit Union of Montevideo
Linda Givan
Linda Givan
President